* **HIGH COURT OF DELHI : NEW DELHI**

\+ **ITA No. 1315 of 2006**

Judgment reserved on: August 06, 2007

% Judgment delivered on: September 21, 2007

Commissioner of Income Tax
(Central)-III, New Delhi. ...Appellant

Through Mrs.P.L. Bansal, Advocate

Versus

M/s. J.S. Electronics Pvt. Ltd.
44, Friends Colony,
New Delhi. ...Respondent

Through Mr.Ajay Vohra with Mrs. Kavita Jha, Advocates

Coram:

HON'BLE MR. JUSTICE MADAN B. LOKUR
HON'BLE DR. JUSTICE S. MURALIDHAR

1. Whether the Reporters of local papers may be allowed to see the judgment? Yes

2. To be referred to Reporter or not? Yes

3. Whether the judgment should be reported in the Digest? Yes

MADAN B. LOKUR, J.

The Revenue is aggrieved by an order dated 24th August, 2004 passed by the Income Tax Appellate Tribunal, Delhi Bench 'F' in ITA No.1508/Del/1999 relevant for the assessment year 1992-93.

2. The Assessee is a private limited company dealing in shares. The Assessee came to know that the erstwhile HCL had entered into a joint venture agreement with Hewlett Packard, USA and that in terms thereof, shares of the erstwhile HCL would effectively be transferred to HCL Ltd. and HCL HP Ltd. In fact, a scheme of arrangement to this end was prepared and sanctioned under Sections 391 and 394 of the Companies Act, 1956 by this Court. One of the terms of the scheme of arrangement, with which we are concerned, provided that the shareholders of the erstwhile HCL would receive, for 100 shares held by each shareholder, 68 shares of HCL HP Ltd. and 32 shares of HCL Ltd. The Assessee also came to know that Hewlett Packard, USA would buy the shares of HCL HP Ltd. at a predetermined price of Rs.168.80 per share.

3. Based on this information, the Assessee purchased 7,77,100 shares of the erstwhile HCL. Out of these, the Assessee sold 1,29,600 shares on various dates leaving behind a balance of 6,47,500 shares of the erstwhile HCL.

4. In terms of the joint venture agreement, for these 6,47,500 shares the Assessee was allotted 4,40,300 shares of HCL HP Ltd. and 2,07,200 shares of HCL Ltd.

5. Out of the 4,40,300 shares of HCL HP Ltd. held by the Assessee, it sold to Hewlett Packard, USA 1,14,486 shares at the predetermined price of Rs.168.80 per share.

6. On these broad facts, two issues arose before the Assessing Officer on the return of income filed by the Assessee. The first issue concerned the high price paid by the Assessee for the purchase of shares of the erstwhile HCL. The second issue concerned the valuation of the closing stock of shares held by the Assessee.

7. With regard to the first issue, the explanation given by the Assessee for purchasing shares of the erstwhile HCL at a high price was that it had purchased a large number of shares in large blocks from the Delhi Stock Exchange. The Assessee submitted that necessary brokers' notes were available and the payment made to the brokers was by account payee cheques. In other words, according to the Assessee, the transactions were above board. The Assessing Officer did not accept this explanation and made an addition of Rs.89,29,635/- to the income of the Assessee on account of the high price paid by the Assessee for the purchase of shares of the erstwhile HCL.

8. In so far as the second issue regarding valuation of the closing stock of shares is concerned, the Assessee worked out the average cost of the shares of HCL HP Ltd. at Rs.55.82 per share. The Assessing Officer took the view that the market price for the shares of HCL HP Ltd. was Rs.100/- per share and on this basis he made an addition of Rs.1,40,94,839/- to the closing stock of shares held by the Assessee.

9. The Assessee challenged both the conclusions arrived at by the Assessing Officer but the Commissioner of Income Tax (Appeals) [CIT (A)] by his order dated 31st October, 1995 rejected the challenge. The Assessee then preferred an appeal before the Tribunal which passed an order on 20th January, 1997. This order is of some importance because the Tribunal remanded the matter to the file of CIT (A) for passing a speaking order and also gave certain directions.

10. The direction given by the Tribunal with regard to the first issue concerning the addition of Rs.89,29,635/- on account of the high price paid for the shares of the erstwhile HCL was that the CIT (A) should examine the matter in the light of Section 40A(2) of the Income Tax Act, 1961 (the Act) or determine whether the transaction entered into by the Assessee with the brokers was a sham or bogus transaction. The Tribunal was also of the view that a mere difference in the purchase price was not enough to sustain an addition and the explanation given by the Assessee needed to be examined.

11. As regards the second issue relating to the valuation of the

closing stock of shares, the Tribunal directed the CIT (A) to examine the matter in the light of Section 49(2) of the Act and also to take into consideration the fact that shares of the erstwhile HCL were split up into shares of HCL HP Ltd. and HCL Ltd.

12. The CIT (A) then heard the matter on remand in terms of the directions given by the Tribunal. In respect of the first issue, the CIT (A) came to the conclusion that the Assessing Officer had taken the price of the shares of the erstwhile HCL as prevalent in the Bombay Stock Exchange while the Assessee had actually made purchases from the Delhi Stock Exchange. Moreover, the transaction was confirmed by the brokers and payments were made to the brokers through account payee cheques. The transactions did not appear to be sham transactions and the Assessing Officer had not brought on record any evidence to show to the contrary or that any part of the consideration had come back to the Assessee. It was noted that the Assessee had some special knowledge about the joint venture and the scheme of arrangement and was, therefore, willing to pay a higher price to corner the shares. The CIT (A) came to the conclusion that Section 40A(2) of the Act was

inapplicable inasmuch as the expenditure was neither excessive nor unreasonable nor was the transaction a sham and, therefore, the addition of Rs.89,29,635/- was incorrect and was deleted.

13. With regard to the second issue of the addition of Rs.1,43,29,635/- being the difference in the valuation of the closing stock of shares on the basis of its market value, the CIT (A) examined the case in the light of the provisions of Section 49(2) of the Act. He noted that the Assessing Officer had completely lost sight of the scheme of arrangement which required the splitting up of the shares of the erstwhile HCL into the shares of HCL HP Ltd. and HCL Ltd. and that the Assessee was entitled to value the shares of HCL HP Ltd. at the cost price of Rs.55.82 per share rather than the undetermined market value of Rs.100/- per share. It was, accordingly, held by the CIT (A) that the addition was not tenable.

14. Feeling aggrieved by the order passed by the CIT (A), the Revenue preferred an appeal before the Tribunal.

15. On a reading of the order of the Tribunal, we find that the submissions before it really centred around the interpretation of the earlier order dated 20th January, 1997 passed by the Tribunal when it remanded the case to the CIT (A) and whether the directions given by the Tribunal were correctly interpreted and implemented by the CIT (A). In this regard, the Tribunal came to the conclusion that the CIT (A) correctly understood the earlier order passed by the Tribunal on 20th January, 1997 and had fully implemented it.

16. On the merits of the case, the Tribunal held that on the first issue, the CIT (A) had clearly held that no case had been made out for invoking the provisions of Section 40A(2) of the Act or to hold that the transactions entered into by the Assessee were sham transactions. The explanation given by the Assessee for purchasing the shares of the erstwhile HCL at a high price was plausible and since the payments made to the brokers were through account payee cheques, there was enough material to negate all doubts about the transaction being a sham. Moreover, there was nothing to show that any part of the amount came back into the coffers of the Assessee.

17. As regards the second issue, the Tribunal noted the contention of the Departmental Representative that Section 49(2) of the Act was not applicable. It, however, held that since the earlier order passed by the Tribunal on 20th January, 1997 was accepted by the Revenue, it was now not possible for the Departmental Representative to contend that Section 49(2) of the Act was not applicable.

18. The question whether the closing stock could be valued at the cost price or the market value was conclusively settled, as noted by the Tribunal, by the decision of the Supreme Court in ***Sakthi Trading Co. v. Commissioner of Income-tax, [2001] 250 ITR 871*** wherein it is held:

> "It is an established rule of commercial practice and accountancy that where there is no discontinuation of business, the closing stock is to be valued at cost or market price, whichever is lower."

On these facts, the Tribunal found that there was no error committed by the CIT (A).

19. We are of the view that the scope of enquiry before us is

rather limited in view of the order passed by the Tribunal. The only question that really arises before us is whether the CIT (A) correctly understood and implemented the earlier order passed by the Tribunal on 20th January, 1997. The Tribunal has found no error in the view taken by the CIT (A). We do not find any reason to interfere in this regard because this is essentially a matter of understanding the order of the Tribunal which does not lead to any substantial question of law.

20. On merits also, we find that the explanation given by the Assessee with regard to the first issue was a plausible explanation and could not be termed as perverse. The CIT (A) as well as the Tribunal were quite justified in examining the explanation and coming to a conclusion thereon which is that the transactions of purchasing shares of the erstwhile HCL at a high price were not sham transactions. This is essentially a question of fact which ought not to be disturbed unless it is perverse which, in our opinion, is not so. Both the CIT (A) and the Tribunal have considered the relevant facts and the submissions of the parties in the right perspective. As regards the second question about valuation of the closing stock, the Assessee was well within its rights to

value the closing stock at cost price which was lower than the market price. The action of the Assessee is fully backed by the decision of the Supreme Court in ***Sakthi Trading Co.*** and no fault can be found in the stand taken by the Assessee in this regard.

21. No substantial question of law arises for our consideration. The appeal is dismissed.

Madan B. Lokur, J

September 21, 2007 **S. Muralidhar, J**
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Certified that the corrected copy of the judgment has been transmitted in the main Server.